Experiential Learning: Shareholder Engagement in a Student-Managed Investment Fund

Kent Saunders
Anderson University
ktsaunders@anderson.edu

ABSTRACT: In many universities, innovations in financial education have allowed a movement beyond simulations to student management of real dollar funds. Through the investment of real money, students have the additional responsibility to act as stewards on behalf of their clients. When purchasing equities as part of their investment portfolio, students can practice real-life shareholder advocacy and engagement through socially responsible investing. The focus of this paper will be the experience of shareholder engagement within a student-managed investment fund at Anderson University. Specifically, this paper will detail the experience of attending actual annual meetings in person and online, completing corporate visits, proxy voting, and writing shareowner proposals.

INTRODUCTION

Luke 14:28
"Suppose one of you wants to build a tower. Won't you first sit down and estimate the cost to see if you have enough money to complete it?"

Armstrong and Wiese (1992) describe the "Salt and Light" model for the development of a Christian business program. Further, Wiese, Armstrong and Erickson (2006) call for faculty to be entrepreneurs in their areas of core competency and professional passion. The creation of a student-managed investment fund at Anderson University in the spring of 2007 was my answer to this call.

Student-managed investment funds provide students the opportunity to manage a portfolio of real-dollar investments and earn academic credit. Student-managed funds typically benefit a university through improved course offerings within the field of finance where academic knowledge and practical experience are developed simultaneously.

Socially responsible investing (SRI) is the practice of using both financial and social criteria when making investment decisions. The goal of SRI is to invest in companies and organizations displaying values comparable to one's own. SRI strategies may include screening (refraining from investing in corporations with products or policies inconsistent with one's values), engaging management (actions taken to improve corporate disclosure, policies, performance and governance), and community investing (investing in communities that are underserved by traditional financial markets and services).

The focus of this paper will be the application of shareholder engagement within a student-managed investment fund at Anderson University. Specifically, this paper will detail the experience of attending actual annual meetings in person and online, visiting corporations, proxy voting, and writing shareowner proposals. The paper will begin with a literature review of both student-managed investment funds and SRI.

LITERATURE REVIEW

Matthew 25:19-21
"After a long time, the master of those servants returned and settled accounts with them. The man who had received five bags of gold brought the other five. 'Master,' he said, 'you entrusted me with five bags of gold. See, I have gained five more.' His master replied, 'Well done, good and faithful servant! You have been faithful with a few things; I will put you in charge of many things. Come and share your master's happiness!'"

Student-Managed Funds

Dewey (1938) is generally cited as the first to promote a "learn-by-doing" education model. The first wide-scale attempt at using a "learn-by-doing" approach in investments was the use of simulations. Branch (1975), Fischer and Madden (1979), and Burns and Burns (1982) all promoted the use of simulations as an effective way to learn investments and stimulate student interest. There are pitfalls with the use of simulations. Halberg (2001) believes that hypothetical investing may promote "investment behavior antithetical to classroom instruction." Saunders (1999) notes that most simulations cater to a short-term horizon where "speculative and risky strategies, such as buying on margin and investing in only a few stocks, are encouraged" (p. 186). Due to some of the speculative and risky strategies that develop when using simulations, Kagan, Mayo, and Stout (1995) suggest that risk-adjusted returns should be calculated to introduce the values of diversification.

In several universities, innovations in financial education have allowed a movement beyond simulations to student management of real-dollar funds. The use of student-managed investment funds as an applied learning technique in finance was first reported by Belt (1973), Hirt (1977) and Bear and Boyd (1984). Moses and Singleton (2005) have found that "real-dollar portfolios have higher educational value" relative to simulations (p. 36). Haddad and Redman (2006) report that student-managed funds can produce superior returns relative to the S&P 500.

The number of student-managed funds has grown dramatically over the past 40 years (Mallett, Belcher, & Boyd, 2010). Lawrence (1994) reported that the number of funds grew from seven in 1972 to 37 in 1993. Neely and Cooley (2004) conducted a survey of 128 student-managed funds in 2004. Root, Rozycki, Senteza and Suh (2007) found that 15 percent of AACSB and two percent of non-AACSB schools offer students the opportunity to manage real funds as a part of the finance major. Lawrence (2008) reported that there are now more than 300 student managed investment funds worldwide.

Block and French (1991), Kahl (1997), and Cooley and Hubbard (2012) describe the process for starting and operating student-managed funds. Most of the funds created prior to the mid-1980s were created by lump-sum gifts. A trend in using a portion of a university's endowment for student management was first reported in Tater (1987) and Lawrence (1990).

Grinder, Cooper, and Britt (1999) describe how student-managed funds allow students to use different "learning styles" (Gardner, 1983) to achieve higher levels of learning in the cognitive domain (Bloom, Engelhart, Furst, Hill, & Krathwohl, 1956) and apply professional values and an ethical framework in terms of the affective domain (Krathwohl, Bloom, & Masia, 1964). Thus, the use of student-managed investment funds can provide students with practical experience in dealing with ethical issues as they pertain to finance. One way to make the application of ethics into investment decision making more intentional is to conduct "socially responsible" investing.

Socially Responsible Investing, SRI

Viviers and Eccles (2012) note the faith-based origins of SRI with some early examples tracing back to the anti-slavery campaigns of the Quakers in the 1700s, the investment needs of religious groups as early as the 1920s, the anti-apartheid movement of the 1980s, and up to the environmental, social, and corporate governance issues of today. The Forum for Sustainable and Responsible Investment (2012) reports that "one out of every nine dollars under professional management in the United States is invested according to strategies of sustainable and responsible investing" (p. 11).

Statman (2005) points out that "companies are arrayed on a continuum; no company is perfectly socially responsible or irresponsible" (pp. 17-18). Some socially responsible funds exclude companies that receive "any" revenues from certain products or services while other funds exclude only companies who earn "substantial" revenues (e.g., 20 percent) from certain products or services (Statman, 2006).

Capelle-Blancard and Monjon (2012) find that most SRI studies focus on financial performance. The findings of Hamilton, Jo, and Statman (1993); Kurtz (1997); Sauer (1997); Goldreyer, Ahmed, and Diltz (1999); and Statman (2000) find that socially screened portfolios perform comparably to their unscreened peers. One might think that socially responsible funds may lose out on some diversification benefits due to screening. However, Boutin-Dufresne and Savaria (2004) and Bello (2005) find that socially responsible funds do not differ significantly from conventional funds in terms of diversification benefits.

Socially Responsible Investing in Student-Managed Investment Funds

The use of SRI strategies is one way to bring the application of ethics into investment decision making more intentional. SRI strategies typically involve one or more of the following: screening, shareholder engagement, community investing. Mallett, Belcher and Boyd (2010) and Lawrence (2008) identify several schools (e.g., Bluffton University in Ohio and Villanova University) that have investment policies that screen stocks on the basis of socially responsible criteria. Clinebell (2013) presents issues surrounding the creation and operation of a SRI fund. Clinebell (2013) notes that one of the distinguishing features of the fund at the University of Northern Colorado is that the investment policy statement considers both security screening strategies and indirect community involvement strategy where students present and vote on shareholder resolutions for the stocks held in the portfolio.

Saunders (2008) compares and contrasts the investment policies and objectives between religiously affiliated and independent private colleges and universities. Saunders (2008) finds that just over one in three church-affiliated and independent colleges conduct some form of SRI strategy in the running of their student-managed fund with church-affiliated institutions more likely to conduct screening activities and independent institutions more likely to conduct engagement and community investing strategies. Swicegood (2014) provides an example of a "community investing" strategy with a micro-lending program in Haiti that uses a portion of their student-managed fund proceeds.

SHAREHOLDER ENGAGEMENT IN A STUDENT-MANAGED INVESTMENT FUND

Ecclesiastes 11:2

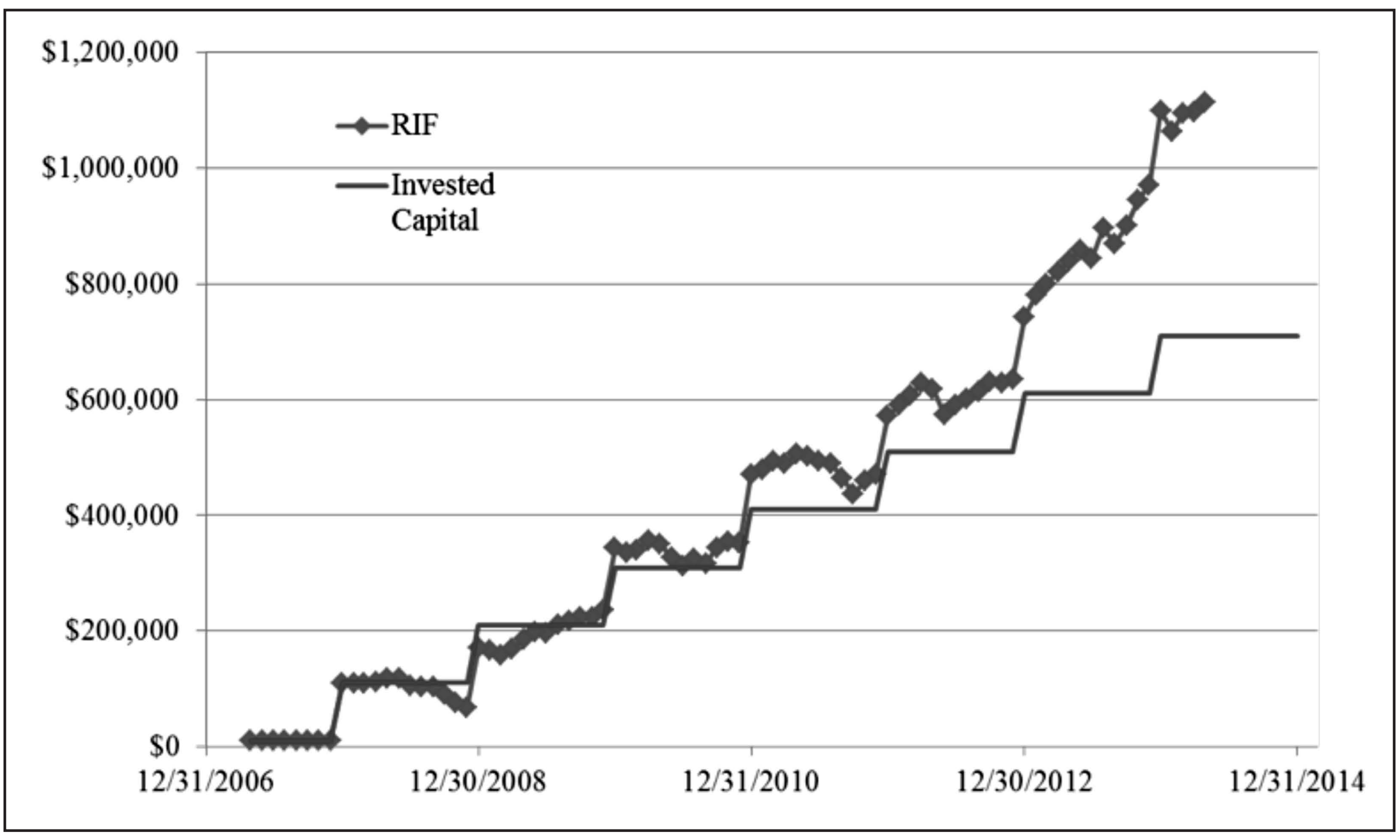
"But divide your investments among many places, for you do not know what risks might lie ahead."

The focus of this paper is to present ways that a student-managed fund can practice SRI through shareholder advocacy and engagement. Specifically, this paper will discuss the experience of the Anderson University Raven Investment Fund (RIF) attending shareholder meetings in person and online, visiting corporations, proxy voting, and writing shareowner proposals.

Anderson University Raven Investment Fund

In April of 2007, the Raven Investment Fund (RIF) was established with an initial investment of $10,000 from the Falls School of Business. In the spring of 2007, the students enrolled in the Portfolio Management course (BSNS 4160) presented recommendations to the Investment Committee of the Anderson University Board of Trustees and requested that future students be entrusted with the management of

Table 1: Raven Investment Fund Monthly Portfolio Balance Relative to Invested Capital



$1 million of the university's endowment. The request for $1 million was not approved; however, students enrolled in BSNS 4160 in the spring of 2008 were entrusted with $100,000 of the university's endowment. Every spring since 2008, the RIF presents the yearly performance of the fund and makes recommendations for the future to the Investment Committee of the Anderson University Board of Trustees, and based on these presentations, students have been entrusted with an additional $100,000 each year for a total of $710,000 in invested capital. In the spring of 2014, with the help of the invested capital and capital appreciation, the RIF managed over a million dollars of the university's endowment. Figure 1 represents the monthly portfolio balance relative to invested capital. The next few sections of the paper will describe the shareholder engagement activities that have been a part of the management of the RIF.

Attending Annual Shareholder Meetings in Person and Online

One of the more powerful ways to bring home the realization that a student-managed fund oversees real money is to attend a shareholder meeting in person. Typically, the RIF seeks to attend one annual meeting per year. Attending an annual meeting allows students to see firsthand how corporations present their historical performance and expectations for the future to their shareholders. Additionally, students learn how corporate governance issues are presented, discussed, and voted on.

Sometimes an annual meeting will take place within an easy drive from our campus. In 2009, we were able to drive to Indianapolis to attend the annual meeting of Eli Lilly and Company. While attending the annual meeting, students were able to meet the Chairman and CEO John Lechleiter in person, see Figure 2.

Figure 2: Attending the Eli Lilly Annual Meeting in 2009

More often than not, it will not be possible to attend an annual meeting in person. However, depending on when the class meets, it is very easy to listen in and watch live annual meetings through online connections. In the fall of 2012, our investments class listened to the Procter & Gamble annual meeting webcast during class. Also, many corporations leave the audio and video broadcast links up for a few weeks after their annual meeting. This allows for either in-class or outside-of-class listening when the timing is not right for a live listen-in.

Corporate Visits

An additional way to leverage the benefit of being an actual shareholder is to organize field trips and corporate visits. In 2011 the RIF held shares in ACE Limited headquartered in Zurich, Switzerland. The Falls School of Business was going on a Christmas break trip to Zurich and we contacted shareholder relations with ACE to arrange a corporate visit. Our contact with shareholder relations advised that a visit to ACE would not be very exciting; however, they were able to arrange a corporate visit and tour of the trading floor of Credit Suisse in Zurich. In a similar vein, the Falls School of Business went on a spring break trip to Seattle in 2014. The RIF owns shares in Amazon and Costco, both of which are headquartered in the Seattle area. Using our shareholder relations contacts with these firms, we were able to arrange for a corporate visit and shareholder presentation with each firm while we were there.

Proxy Voting

The RIF has an account with TD Ameritrade, and we receive shareholder communications via e-mail. The e-mail requesting voting instructions for the annual meeting is sent directly to the instructor. This email typically includes a link to the annual report, the proxy statement, and a link to proxyvote.com. The instructor forwards the email to the student who is responsible for that particular holding. It is the student's responsibility to read through the related materials and present a recommendation to the class as to how we should vote our proxy. The student will create a "Proxy Vote Proposal" that they will send to the class prior to their presentation. Figure 3 presents a sample proxy vote proposal from the spring 2012 semester.

After the proxy vote proposal presentation, the class reviews the student's recommendation and asks questions prior to voting the proxy. All proxy decisions are determined by a class vote. The entire class is eligible to vote. Decisions require 70 percent approval of students in attendance as long as at least 70 percent of the total class

Figure 3: Sample Proxy Vote Proposal

Consumer Discretionary Sector (XLY): YUM! Brands Inc. (YUM)
Student Analyst: Wesley Becker
April 18, 2012

Item 1: Election of Directors and Director Biographies

- Of the 11 candidates, 2 are not independent (one for previous affiliations to the company, and the other for his position as current CEO).
- *Recommend voting against the current CEO due to a lack of segregation of duties. I believe that the Chairman of the Board and the CEO should be independent. The reasoning for voting in favor of the other is listed under Item 4.*

Item 2: Ratification of Independent Auditors

- YUM proposes the continuation of KPMG as their external auditors.
- *Recommend voting in favor of KPMG.*

Item 3: Advisory Vote on Executive Compensation

- YUM proposes compensating the executives for their performance this past year.
- *As YUM has had a 17% return while the industry has been relatively flat so I recommend voting to compensate the executives for their performance.*

Item 4: Shareholder Proposal regarding Independent Board Chair

- A shareholder proposal suggesting that the board of director's adopt a policy that requires the Board's chairman be an independent director.
- *Recommend voting against this proposal because it excludes those who were previously not independent, whom I believe can provide valuable insight.*

Item 5: Shareholder Proposal regarding Palm Oil

- Shareholder request that the board of directors adopt and implement a comprehensive sustainable palm oil policy.
- *Recommend voting against this proposal because YUM already has existing policies in place regarding sustainability.*

enrollment is present. The RIF holds about 30 different equities, and we typically vote about 15 proxy statements each spring semester.

Writing a Shareowner Proposal

The RIF has submitted a shareowner proposal in the fall of 2012 and the fall of 2013. The process for researching, writing, submitting, and responding to our proposals followed a similar timeline in both cases. The first step in the process was to identify an issue.

<u>Identifying an Issue</u>

Previous classes, through voting proxies, became aware of current corporate governance issues (e.g., separating the role of the chair and CEO for YUM/JNJ/3M/JPM). In their annual report the previous classes suggested that future classes consider these specific issues. The 4150 classes in the fall of 2012 and 2013 focused on separating the role of the chair and CEO and did further research on this issue. The dual role of CEO and chair of the board is a common measure of board independence (Ertimur, Yonca, Ferri, Gabrizio & Stubben, 2010). The Spencer Stuart Board Index 2013 reports that the percentage of independent board chairs has increased from 16 percent of S&P 500 companies in 2008 to 25 percent in 2013 and the percentage of S&P 500 companies who separate the roles of the chair and CEO has increased from 23 percent in 2003 to 45 percent in 2013. Gotsias and Tompkins (2013) provide a role-playing exercise in which students learn about some of the major conflicts of interest in the corporation, one of them being agency problems that arise when the CEO also serves as the chair of the board. Based on previous class suggestions and their own research, both the fall of 2012 and 2013 classes decided to write a proposal related to separating the roles of the chair and the CEO.

Identifying Companies

The specific issue that was to be addressed (i.e., separating the role of the chair and CEO) was not relevant for all equities held in the portfolio. Also, in order to submit a shareowner, proposal we needed to continuously own more than $2,000 worth of stock for over one year. Finally, the deadline for submitting a proposal is well in advance of the annual shareowner meeting. Thus, we looked for companies with the following criteria: (1) the issue was relevant, (2) we owned $2,000 in equity for more than one year, (3) the shareowner proposal submission deadline was in the fall semester so the 4150 class could submit the proposal as part of the fall course content, and (4) the annual meeting took place during the spring semester so that the 4160 class could attend the meeting and present the proposal as part of the spring course content. In the fall of 2012, the 4150 class identified The Coca-Cola Company and in the fall of 2013 the 4150 class identified United Technologies as companies that meet all of the criteria. Hence, the proposals were written specific to those companies. Appendix 1 contains the shareowner proposal submitted to United Technologies in the fall of 2013.

Shareowner Proposal Submission

The Council of Institutional Investors (2011) created a document that provides an overview of the process to file a shareowner proposal, which includes a sample cover letter when submitting a proposal. Appendix 2 contains the actual cover letter submitted to United Technologies in the fall of 2013.

In both the fall of 2012 with The Coca-Cola Company and in the fall of 2103 with United Technologies, we received a deficiency notice from the company. For example, in the fall of 2013, our cover letter was dated October 31 and the letter from TD Ameritrade was dated October 29. So, we needed to provide an additional letter from TD Ameritrade documenting ownership through October 31. Also, the letter from the vice president for finance and treasurer in our initial submission was not sufficient evidence that we were authorized to act on behalf of Anderson University. We were able to document this authorization by sending a notarized copy of Board minutes that indicated our authority. Thus, we learned a great deal about the necessary verbiage and mechanics that are involved in order to get a proposal officially submitted.

Engagement Outreach on Behalf of the Corporation

As a result of our proposal submission in the fall of 2012, we were visited on campus by Mark Preisinger, director of corporate governance for The Coca-Cola Company. After our on-campus visit from Mark Preisinger, we also received a letter from James D. Robinson III, the presiding director of The Coca-Cola Company. As a result of our proposal submission in the fall of 2013, we were visited on campus by Peter J. Graber-Lipperman, vice president, secretary and associate general counsel and Jay Malave, director of investor relations for United Technologies. From the interaction and engagement with both companies, students learned about "unity of command," "independent" and "presiding" directors, and a lot more of the details of the corporate governance structures at these companies that provide independent oversight from their boards. In both cases, the students were able to ask and get answers to all of their questions either live and in person or via follow-up email.

Decision to Withdraw Our Proposal

After receiving answers to all of their questions, the students met during class time to discuss how to proceed with their proposals. In both cases, the students decided to withdraw their proposal, but they thoroughly enjoyed the engagement process. The shareowner writing process enabled the students to experience firsthand what is involved with taking on a more active role in responsible investing while providing invaluable experience. Even though the students did not have their shareowner proposal appear on a proxy, the writing, interacting, and learning gained from the engagement process was invaluable.

CONCLUSION

Luke 16:10-12

"Whoever can be trusted with very little can also be trusted with much, and whoever is dishonest with very little will also be dishonest with much. So if you have not been trustworthy in handling worldly wealth, who will trust you with true riches? And if you have not been trustworthy with someone else's property, who will give you property of your own?"

I recently asked a handful of former students if they would be willing to provide a quote related to their experience with the Raven Investment Fund. Below are their responses:

> The Raven Investment Fund provided a great opportunity to begin live trading in a controlled environment. Not only did this require collaboration from students in the class, it also provided the chance to report results to the oversight committee at the end

of the semester. These experiences have been directly applicable to my career after college and have helped me be more comfortable in a corporate atmosphere.
—Adam Klunzinger, Class of 2009

The Raven Investment Fund was one the most influential classroom experiences I had at Anderson University. As a senior, I was able to aggregate the technical and interpersonal skills I developed at the Falls School of Business and put them to use in a real-time, real-world setting. I worked daily with my peers to develop real strategies for investment, both hedging risk and maximizing return. I developed skills in group decision making, strategic planning, and data analysis that I use every day in my career. Though I did not choose a career as a stock broker, investment analyst, or financial adviser, the Raven Investment Fund experience was a key contributor in making me the leader and businessman I am today.
—Dan Stichter, Class of 2009

I really believe that the Raven Investment Fund was one of the top experiences I had in college that not only taught me about the real world but that gave me the ability to show my knowledge and genuine interest in finance to employers. I was asked in every interview about my experience with the Raven Investment Fund and it was often an edge on the competition.
—Fede Boscaini, Class of 2012

Many institutions across the nation have courses in which students study market sectors, investment strategies, and even manage simulated portfolios. However, if the equity is not owned, there are learning opportunities that may be missed. Being a part of the Raven Investment Fund allowed us as students to interact with investor relation personnel. In fact, because of our shareholder proposal, the director of investor relations for The Coca-Cola Company came and visited our class regarding our proposal. Opportunities such as these are what makes being part of the Raven Investment Fund such a valuable learning opportunity. —Nathan Cooper, Class of 2013

Student-managed investment funds provide students the opportunity to manage a portfolio of real-dollar investments and earn academic credit. Student-managed funds benefit a university through improved course offerings within the field of finance where academic knowledge and practical experience are developed simultaneously. As shareholders, students can experience real stewardship and practice shareholder advocacy and engagement through attending actual annual meetings in person and online, visiting corporations, proxy voting, and writing shareowner proposals.

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APPENDIX 1: SAMPLE SHAREHOLDER PROPOSAL FOR UNITED TECHNOLOGIES

RESOLVED: We request the Board of Directors to adopt a policy and amend the bylaws as necessary to require the chair of the Board of Directors to be an independent member of the Board. This independence requirement shall apply prospectively so as not to violate any contractual obligation at the time this resolution is adopted.

Supporting Statement

Louis R. Chenevert currently serves as both the chair of the Board of Directors and as the CEO. We believe that having the company's CEO also serve as the Chair of the Board is detrimental to the company. Currently, our CEO is the only director who is not independent. United Technologies is a large, diversified industrial corporation with operations throughout the world. Serving as the CEO is a full-time job. Our CEO should be solely focused on innovation, adjusting to rapidly changing technologies, business cycles, and competition. We realize that the other eleven board members are independent; however, we believe that for the Board to be truly free from conflicts of interest, the CEO should not also serve as the chair. For a company that prides itself on its diversification and innovation, we believe that separating the roles of CEO and chair is appropriate. The board is in place to govern the company from the outside and not give any unfair advantages to anyone on the inside. Former Intel Chairman Andrew Grove stated, "The separation of the two jobs goes to the heart of the conception of a corporation. Is a company a sandbox for the CEO, or is the CEO an employee? If he's an employee, he needs a boss and that boss is the board. The chairman runs the board. How can the CEO be his own boss?" The Board of Directors is in charge of overseeing management and the operation of the company, which is very similar to the relationship of an auditor and financial statements. If an auditor or audit firm loses independence, it is liable for negligence. The same liability should be applied for the board because it has lost independence. The CEO is in charge of managing the company while the board oversees the CEO on behalf of shareholders. Serving in both roles takes away from the focus needed on critical decisions made by the CEO to run the company. The roles of CEO and chair of the Board should not be combined. According to the 2012 Spencer Stuart Board Index, 43 percent of S&P 500 companies split the roles of CEO and chair of the Board, up from 35 percent in 2007. Serving as the CEO and chair of the Board is an unnecessary conflict of interest that does not exemplify the best practices in corporate governance.

APPENDIX 2: SAMPLE COVER LETTER FOR UNITED TECHNOLOGIES

October 31, 2013

Corporate Secretary
United Technologies Corporation
One Financial Plaza
Hartford, CT 06101
Re: Shareholder proposal for the 2014 annual meeting

Corporate Secretary,

On behalf of Anderson University, I submit the enclosed shareowner proposal for inclusion in the proxy statement that United Technologies plans to circulate to shareowners prior to the 2014 annual meeting. I am the professor for BSNS 4150 and BSNS 4160 at Anderson University and myself and the students in enrolled in these classes manage a portion of the Anderson University endowment through an account set up with TD Ameritrade. I am including a statement from the Anderson University vice president for finance and treasurer, Dana Stuart, indicating that I am authorized to submit the proposal on behalf of Anderson University. The proposal is being submitted under SEC Rule 14a-8.

Anderson University is located at 1303 E. 5th Street, Anderson, IN 46012-3468. Anderson University owns 215 shares and has continuously owned more than $2,000 worth of United Technologies common stock for longer than a year. A letter from our broker, TD Ameritrade, confirming that ownership is enclosed. Anderson University intends to continue ownership of at least $2,000 worth of United Technologies common stock through the date of the 2014 annual meeting, which I (along with some of students from BSNS 4160) am prepared to attend.

I would be pleased to discuss the issues presented by this proposal with you. If you require any additional information, please let me know.

Sincerely,

Kent Saunders
Professor of BSNS 4150 and BSNS 4160

Enclosures